GROWING A CULTURE OF SOCIAL IMPACT INVESTING IN THE UK

EXECUTIVE SUMMARY

In 2016, the UK government set up an independent advisory group to answer an important question:

How can the providers of savings, pensions and investments engage with individuals to enable them to support more easily the things they care about through their savings and investment choices?

The reason for the question was that the UK had long been a leader in social impact investing, but individuals who wanted to make impact part of their personal savings and investment choice still found it hard to do so. The advisory group was asked to look into the reasons for that failure and recommend potential solutions.

The UK has been a pioneer in social impact investing. The Treasury first established a taskforce to investigate how entrepreneurship could be applied to combine financial and social returns in 2000. The UK again took the initiative in 2012 and 2013, launching Big Society Capital, a wholesale social investment institution, to grow the market and then establishing a Social Impact Taskforce and National Advisory Board during its presidency of the G8, helping take the idea global. In 2015 this led, among other things, to the Social Impact Taskforce being expanded into the Global Impact Investment Steering Group of 13 member states plus the EU.

The establishment of Big Society Capital and the National Advisory Board on Impact Investing were bold innovations that have been admired and sometimes replicated in other parts of the world. Yet closer to home, the UK is now failing to keep pace in enabling individuals to make social impact investments, despite the availability of exceptional skills, competence and the entrepreneurial drive to build on an impressive track record of innovation.

The risk is not due to a lack of demand. Younger savers in particular often see positive social outcomes as a key element in their investment decisions, and rising interest from that group is beginning to be reflected in the wider investment community. However, products that embed social impact investing are scarce, with the consequence that they are not at the forefront of financial adviser or pension trustee thinking when investment allocation decisions are made.

Reasons for a lack of investable products include the fact that social impact investment opportunities can be difficult to identify and crystallize; many are early stage, implying material credit and liquidity risk. In addition, there is sometimes a challenge in explaining social impact intentions to investors who think more in financial terms. Consistent measurement of track record and non-financial returns are still a work in progress.

Perhaps not surprisingly given those challenges, there is also some investor inertia, with enthusiasm for social impact investing yet to be reflected fully in volumes. A recent survey of 1,800 individuals in the UK revealed that 56% had at least a moderate interest in impact investing, but only 9% had already invested.[1]

Having looked into the reasons why the UK is not fulfilling its potential for social impact investing, the advisory group has concluded that none are insurmountable. In fact, there is a real opportunity to build on a history of social impact innovations in the UK and contribute actively to global sector leadership.

Achieving these aims will require a sustained commitment to creating a culture of social impact investment and savings across UK financial services, its regulatory and supervisory institutions and in government.

In asking for the advisory group to be set up, government has catalysed renewed interest across financial sector leadership. This has included many people previously not directly engaged who now wish to contribute to enabling individuals to invest and save knowing that they are doing good.

Combining this sector determination with that of leaders in social impact around a focused set of actions will provide a unique opportunity to accelerate the changes required to meet growing demand.

The growth of social impact investing

Social impact investing offers financial exposure to the many organisations that carry out socially valuable activities, from providing clean water to fighting poverty and encouraging healthier lifestyles. Its emergence echoes the trajectory of a better-known counterpart, focused on environmental, social and governance investing (ESG). That market has seen billions of dollars of inflows in recent years, reflecting changing attitudes across society. For social impact investing to be set along the same path, appealing to a broadening range of investors and savers, the market must address some tough challenges, including the need to cement its unique identity and develop a set of tools to support growth, educate consumers and raise awareness.

An early task for the advisory group was to find a commonly accepted definition of social impact investing, which remains a matter of some debate. For the purposes of this report it is:

Investment in the shares or loan capital of companies and enterprises that not only measure and report their wider impact on society — but also hold themselves accountable for delivering and increasing positive impact.

The enterprises themselves may either directly focus on social impact or take social impact into account as part of the way they do business.

The report's definition is designed to be a broad church, focused on inclusivity rather than an approach that may exclude organisations that don't regard social impact as a primary objective but have an impact in the way they run their businesses.

A broader definition also reflects the need to improve the contribution of finance to sustainable and inclusive growth, including the ability to fund society's longer-term needs in infrastructure and innovation. Further, it will contribute to better asset pricing (and financial stability) by improving the analysis and management of material non-financial risks to value creation, as highlighted by a recent European Commission report.[2]

Recommendations

Today the UK stands at a critical point in the development of social impact investing. There are strong foundations in place, including deepening investor demand and a growing social impact environment, strongly supported by the government. Financial market participants are also eager to do more, and the UK's strong record on environmental initiatives and corporate governance and reporting augurs well for the development of standards over the coming years.

This report identifies a comprehensive range of recommendations for the short, medium and longer-term. There is no 'silver bullet', but the areas prioritised are practical, achievable and will accumulate, helping to maintain the UK's role as a leader in social impact investing and delivering a choice of quality products to individuals.

The recommendations embrace the full spectrum of social impact investment approaches, reflecting the belief that investment professionals will continue to develop their ability to measure non-financial outcomes, creating opportunities across the full spectrum of social impact enterprises.

1 *The Value of Being Human: A Behavioural Framework for Impact Investing and Philanthropy,* Barclays, 2015.

2 *Financing A Sustainable European Economy, Interim Report,* High-Level Expert Group on Sustainable Finance, 2017.

The recommendations are grouped under five key action areas:

Improve deal flow and the ability to invest at scale

- **Government – Support co-investment:** Government should increase its participation in co-investment models to encourage the provision of capital to social impact investments, potentially taking a first loss position in some circumstances.
- **Financial services industry – Support co-investment:** Industry should commit meaningful ongoing resources to work with government, the social sector and regulators on identifying investment approaches that can be used to deploy capital to tackle entrenched social and economic problems.
- **Companies – Embed positive social impact in business as usual:** Where feasible, companies should increase their focus on creating demonstrable positive social impact alongside financial returns. This would lead to an increase in the number of traditional companies that are achieving measurable social impact and expand the investable universe for impact investors. More consistent outcome reporting linked to UN Sustainable Development Goals (SDGs) will improve investor understanding and help boost confidence in the strategic relevance of non-financial measures over time.

Strengthen competence and confidence within the financial services industry

- **Regulators – Build capability and integrate social impact into business as usual:** Relevant regulators and other statutory bodies, including the Financial Conduct Authority (FCA), Financial Ombudsman Service (FOS), Prudential Regulation Authority (PRA), The Pensions Regulator (TPR) and the Financial Reporting Council (FRC), should continue to build capability in relation to social impact considerations so that, as the market develops, social impact is embedded in regulatory frameworks and understanding.
- **Financial services industry – Build capability and integrate social impact into business as usual:** Industry should engage widely to improve professional skills for social impact; to work with academics and service providers to develop a robust performance/outcome evidence base; to develop with industry bodies initiatives to sustain momentum and ensure quality as the market develops; and to provide tools and training for pension scheme trustees and independent financial advisers (IFAs).
- **Professional bodies – Provide Continuous Professional Development (CPD) and qualifications:** Professional bodies, such as the CFA Institute, the Chartered Institute for Securities & Investment (CISI) and the Chartered Insurance Institute (CII) should accelerate professional development around ESG and social impact investment, through CPD and professional qualifications. They should work with industry to ensure the use of common terms across educational materials.

Develop better reporting of non-financial outcomes

- **Financial services industry – Develop consistent non-financial reporting methods:** Industry should work with the Investment Association (IA) and CFA Society UK to develop consistent good practice and set common standards for social impact investing. This would include determining processes and reporting, potentially using the SDGs as a framework.

- **Government and Financial Reporting Council (FRC) – Explore sustainability and SDG reporting:** The Department for Business, Energy and Industrial Strategy should explore, with the FRC, how best to encourage UK business to increase transparency on the contribution business makes towards the achievement of the UN SDGs. Separately, in regard to the FRC consultation on companies' strategic report, the FRC should explore ways in which material information, useful to wider stakeholders, can be reported in the context of the UN SDGs.

Make it easier for people to invest

- **Government, financial services industry, professional bodies, social sector and regulators – Publish educational material:** Each organisation to publish educational guidance on social impact investment and its relation to ESG, with reference to the others' work to ensure consistency. This should be easily (and independently) accessible for all relevant stakeholders including individual investors, IFAs and pension scheme trustees. In time, government should work with industry on a communications campaign to raise awareness among consumers about the power they have to apply their own values to investment choices.
- **Financial services industry – Develop consistent standards to indicate product integrity to individual investors and trustees:** A cross-sector industry working group, led by the Investment Association, should coordinate the development of best practice. This should initially be around transparency for both ESG integrated funds and for social impact investment products, seeking guidance from organisations such as the British Standards Institution. In time this could lead to an investor-facing social impact investment label as the market develops (see p32: A three-stage approach to developing an investor-facing social impact investment label in time).
- **Financial services industry – Develop more products:** The industry should continue to develop its savings, pensions and investment product suite with the individual investor in mind, utilising both ESG and social impact investment options. Examples of replicable models are shown as case studies throughout the report.

- **Government, financial services industry, professional bodies and regulators – Work on including illiquid assets in investment portfolios:** A wide body of research suggests that an allocation to less liquid, longer term investments is likely to enhance portfolio returns over time, but the financial services ecosystem has developed in a way that biases towards daily pricing and trading. All participants have a role in the systemic change needed to support the inclusion of these assets – many social impact investments currently fall into this category.
- **Pension scheme trustees and employers – Engage better with pension scheme members:** Trustees should work with employers and pension providers to develop best practice for better engaging scheme members with their pension investments and encouraging them to register on their pension platforms. This should lead to better alignment with members' non-financial values, with social impact investments as potential fund choices providing they have an appropriate risk/reward profile. As product track records mature, we also envisage growth in social impact investing as a natural part of default funds.

Maintain momentum and build cohesion across initiatives

- **Financial services industry – Account for progress:** Industry, supported by government, to convene a follow on group to allocate responsibility for taking forward specific actions, to monitor progress and to ensure sustained positive momentum continues. A thought-leadership conference should be held by summer 2018 as part of this process.
- **Financial services industry and professional bodies – Launch high profile awards:** The industry should both stimulate and celebrate progress in social impact investment through awards.

UK consumers have demonstrated their appetite for making a contribution to important causes in the purchasing decisions they make. They have shown a meaningful interest in expressing their values through their investment choices, and the demographic evidence suggests that this interest is likely to continue to grow. On that basis, the foundations are in place for the growth of a thriving and world-leading social impact investment market. The industry, government and stakeholders now have an opportunity to step up and turn that potential into reality.